

DEFENSE ACQUISITION UNIVERSITY
BUSINESS, COST ESTIMATING, & FINANCIAL MANAGEMENT DEPARTMENT

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TEACHING NOTE

WORKING CAPITAL FUNDS

Ellen Rosenthal

BACKGROUND

Working Capital Funds are *revolving* funds that exist to finance the operations of government business units that are managed like a commercial business. The business units in a working capital fund sell goods or services to “customers” with the intent of recovering the total cost incurred in providing those goods and services. The business unit uses the income from the sales to buy or replace inventory, operate the business unit and otherwise finance the production of goods and services. This cycle continues throughout the life of the working capital fund. A working capital fund business unit, unlike a commercial business, is not profit-oriented and therefore only tries to break even on the sale of goods and services.

The basic tenet of the revolving fund structure is to create a customer-provider relationship between the military operating units and support organizations. This relationship is designed to make managers of support organizations funded through the revolving fund and decision-makers at all levels more concerned with the costs of goods and services. Requiring the operating forces to pay for support they receive, provides increased assurance that services supplied and paid for are actually needed.

Revolving funds have been in use by the military components of DoD for a considerable period of time. Modern day authority for the existence of revolving funds is provided by the National Security Act of 1947, as amended (Title 10, U.S.C., Section 2208).

Revolving fund activities evolved from two distinct categories. The first type, Stock Funds, procured material in volume from commercial sources and held these in inventory to be sold to customers needing items to achieve weapon systems readiness or provide personnel support (e.g., uniforms). The second type, Industrial Funds, provided industrial and commercial goods and services such as depot maintenance and transportation. Both of these types of funds were financed primarily by reimbursements from customers' appropriated accounts.

DBOF

Each military component managed several stock and industrial revolving funds of its own until the establishment of the *Defense Business Operations Fund (DBOF)* on October 1, 1991. DBOF combined the nine existing individual revolving funds into a single revolving fund. With the establishment of DBOF, all business activities under the fund were issued annual operating budgets with official management cost goals and capital budget limitations that had not previously existed.

The establishment of a single revolving fund to finance all DoD stock and industrial activities resulted in several improvements in business practices, including full cost visibility, stabilized rates and application of standard policies across the business functions. However, DBOF was capitalized at a level significantly less than the sum of the stock and industrial revolving funds its replaced. This resulted in recurring cash flow problems for the fund. The FY 1997 Defense Authorization Act required DoD to conduct a comprehensive study of DBOF and present its findings and a proposed improvement plan to Congress for approval.

In December 1996, the Undersecretary of Defense (Comptroller) reorganized DBOF and created four Working Capital Funds: Army, Navy, Air-Force and Defense-Wide. Further, in December 1997, a fifth Working Capital Fund was established for the Defense Commissary Agency, effective in FY 1999.

WORKING CAPITAL FUND GOALS AND OBJECTIVES

Working Capital Funds were created and designed to accomplish a number of goals and objectives. These goals include:

- Providing a more effective means for controlling the costs of goods and services provided by the working capital funds and a more effective and flexible means for financing and accounting for those costs.
- Providing managers of working capital funds the financial authority and flexibility required to procure and utilize manpower, materials and other resources effectively.
- Highlighting the cost consequences of various alternatives.

Specific objectives include:

- Providing managers of working capital funds with modern management tools comparable to those used in similar commercial enterprises.
- Improving cost estimates and cost controls.
- Encouraging providers of goods and services to better manage labor, inventories, workload, budgeting and costs control.
- Placing customers in the position to evaluate prices and quality of goods and services.
- Establishing standard prices / rates, to allow customers to plan and budget more confidently.

COST RECOVERY PRINCIPLE

Working Capital Funds were established to do a better job of identifying all the costs associated with producing a specific output. It was recognized that the selling prices charged to customers by the revolving funds should include all the costs involved in providing those goods and services. By giving business unit managers the authority and flexibility to make trade-off decisions, more can be done to control costs, promote efficiencies, and allow sound economic decisions.

As shown in the example below, the old method of accounting for costs only took into account the actual labor of the plumber, but failed to account for all of the support or “hidden” costs associated in supporting that plumber. These costs have always been paid, but they were not necessarily attributed to the cost of having that plumber in the work force. Under the revolving fund financial structure, DoD managers must now determine the “true cost” of having that plumber in the work force and set rates to cover these costs.

Eliminating the Distortion Between “Cost” and “Price”

	<u>Old Way</u>		<u>New Way</u>	
Apparent Customer Cost	Plumber per Hour	\$23	Plumber per Hour	\$37
Hidden Costs	Military Salaries	}		
	Payroll Services			
	ADP Support			
	Safety and Security			
	Special Projects			
	Vehicle Purchase			
	Asset Depreciation			
	Environmental Compliance			
	FECA / Employee Benefits			
	Supply Support			
	Capital Purchases			
Total DoD Cost		\$14		
		<hr/>		<hr/>
		\$37		\$37

STABILIZED RATES

Managers of activity groups within the Working Capital Funds are required to set their prices based upon full cost recovery, including all general and administrative support provided by others. Prices are established through the budget process and except for the Depot Maintenance Activity Group, remain fixed during the year of execution. This *stabilized rate* policy serves to protect customers from unforeseen inflationary increases and other cost uncertainties and better

assures customers that they will not have to reduce programs to pay for potentially higher-than-anticipated prices.

Prices for the budget year should be set to break even in the long run. If an activity group experiences a net operating loss in a particular budget year, the following budget year's stabilized rate should be established so as to enable the activity group to recover that loss. Conversely, if the activity group realizes a net operating gain, subsequent rates should be established to return the gain.

Supply Management activity groups utilize commodity costs in conjunction with a surcharge to cover management and overhead costs to establish customer rates. Non-Supply Management activity groups have unit cost rates based on identified output measures or representative measures (e.g., direct labor hours, items received, items shipped, etc.). These unit cost rates are to be "fully burdened" rates such that the activity group recovers the full cost of providing the output for an anticipated level of demand for the output.

FUNDING

Business areas receive their initial working capital through an appropriation or transfer of resources from an existing revolving fund. This working capital is called the "corpus" and is used to finance the initial costs of goods and services. Resources to replenish the corpus are generated by acceptance of customer orders. Customer orders are obligations on the appropriations of the ordering activity. The business area provides the goods or services ordered using the funds in the corpus, and then bills the customer based on the rates set for those goods and services. The fund is replenished when the customer pays the bill to the fund.

MILITARY COMPONENTS' WORKING CAPITAL FUNDS AND FUNCTIONS

The list below identifies the five Working Capital Funds, the functions that fall under each fund, and some of the organizations that carry out certain functions.

Army Working Capital Fund

Depot Maintenance
Information Services
Ordnance
Supply Management

Air Force Working Capital Fund

Depot Maintenance
Information Services
Supply Management
Transportation

USTRANSCOM

Navy Working Capital Fund

Base Support
Depot Maintenance - Aircraft
Depot Maintenance - Marine Corps
Depot Maintenance - Ships
Information Services
Ordnance
Research and Development
Supply Management
Transportation

Defense - Wide Working Capital Fund

Defense Printing	DAPS
Distribution Depots	DLA
Financial Operations	DFAS
Information Services	DFAS
Information Services	DISA
Information Services	DLA
Reutilization and Marketing	DLA
Supply Management	DLA

Defense Commissary Agency Working Capital Fund

Commissary Operations

ADDITIONAL INFORMATION

The DoD Financial Management Regulation (DoD 7000.14-R), Volume 2B, Chapter 9 contains more detailed information about working capital funds as well as information regarding the preparation of exhibits supporting annual budget requests.

SUMMARY

Working Capital Funds are revolving funds used to finance the operations of industrial and/or commercial-type activities within DoD. Activities financed by the Working Capital Funds establish break-even budgets and set stabilized rates or prices for their customers to use in the budgeting process. These rates or prices generally remain unchanged during the year of execution.

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